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C O N F I D E N T I A L BUENOS AIRES 000629

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LABOR FOR BLS E.TAYLOR AND W.LANE

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TAGS: [ECON](#) [EEFIN](#) [ETRD](#) [EINV](#) [AR](#)  
SUBJECT: ARGENTINA INFLATION CONTROVERSY: GOA TO LAUNCH NEW  
CPI INDEX

REF: BUENOS AIRES 610 159 117 AND PPREVIOUS

Classified By: EconCouns D.P.Climan. Reasons 1.5 (B,D)

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Summary  
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¶1. (C) The GoA plans to roll out a "new and improved" consumer price index (CPI) in June to allow national statistics agency INDEC to recover some of its lost credibility. The new index will measure a narrower basket of goods and services and will allow product weightings to be changed frequently to account for substitution effects in patterns of consumption, quality, and seasonality. Local analysts fear this new methodology offers the GoA significant discretionary power to continue its under-reporting of actual inflation. Many of these analysts argue that the new index will arrive stillborn, particularly because it has been designed and will be measured and calculated by the same people involved in the current inflation misreporting controversy. Clearly, the government will need to work hard to establish the credibility of the new index. End Summary.

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Technical Seminar to Launch New CPI Index  
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¶2. (SBU) On May 7, GoA statistics agency INDEC hosted a day long International Seminar on Inflation Indices "technical" conference on CPI methodology calculation. By special INDEC invitation, Walter Lane, Chief of Consumer Prices of Department of Labor's Division of Consumer Prices and Price Indexes, participated, along with specialists from the Spanish and French statistics bureaus. According to attendees, the 200-strong conference audience appears to have been carefully controlled by INDEC and included large numbers of INDEC employees and union representatives.

¶3. (U) At the conclusion of the conference, Chief of Cabinet Alberto Fernandez announced that, after eight months of testing, a new INDEC CPI measure will be launched in June, measuring May inflation. According to Fernandez, the new CPI index will "update" the basket of goods measured by the current CPI index to better reflect the spending patterns of the Argentine population. This includes reducing the basket measured from about 800 in the current basket to 440. Fernandez also noted that the new index would be a "chained-index" (as opposed to the current fixed-basket index) in which product weightings would be changed frequently to account for substitution effects in patterns of consumption, quality, and seasonality.

¶4. (SBU) Local analysts note that the adoption of a chained CPI index offers the GoA significant discretionary power to re-weight the index, which could be used to smooth or hide increases in inflation and continue alleged misrepresenting of actual inflation. Many of these local analysts argue that the new index will have little credibility since has been designed and will be calculated by the same people that have been involved in the current inflation misreporting controversy (Reftels).

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New CPI: Higher or Lower than Current Official CPI?  
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¶5. (C) Official annualized GoA inflation is currently reported in the 8.8% range. However, according to a number of independent economists who calculate domestic inflation via proxy indicators (e.g. by "deflating" VAT tax collections), inflation currently stands well above 20% year-on-year. Embassy contacts at local economic think-tanks and at international commercial and investment banks who follow this issue tell us they believe that the GoA simply will not allow the new CPI index to acknowledge such a high rate of inflation. Some argue that the GoA, in an effort to regain some of its tarnished credibility, will allow the new index to reflect a few more points of inflation, possibly taking it to the lower teens versus the 8.8% reported under the current index.

¶6. (C) Other analysts are more cynical and point out comments made by the current head of INDEC's CPI division Beatrice Paglieri that the new methodology implies lower consumer price inflation than the current methodology. A report in financial daily Ambito Financiero on May 8 claims that test runs of the new index yielded an inflation rate below the current official one. (Press reports before the resignation of Economy Minister Lousteau reported that he had argued with others over test runs of the new index because they were producing lower inflation numbers.) Analysts here also note that, in the US, the chained CPI measure has been consistently lower than the headline CPI by 0.2% to 0.8% per year, with consequent "underreporting" of the U.S. chained CPI at around one fifth of headline U.S. inflation. With significantly larger price variations in Argentina, they argue that chained CPI underreporting relative to conventional CPI measures will be larger in Argentina.

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Comment  
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¶7. (SBU) INDEC's inflation figures have been under fire for the past 17 months, since its director and key CPI staff were replaced by political appointees in January and February ¶2007. INDEC inflation calculations have since been challenged in local courts by consumer NGOs. Their accuracy has been questioned directly by international financial markets and obliquely by both the IMF and World Bank. Dissident INDEC employees organize public demonstrations regularly, claiming that raw CPI input data has been systematically manipulated to arrive at official inflation figures that -- over the past four months -- are roughly 60% below independent estimates.

¶8. (C) Beyond the technical methodological questions surrounding INDEC's new "chained" CPI calculation, most analysts are focused on whether true market prices will be used as inputs into its calculation. Argentine and international analysts agree that both old and new INDEC CPI indices should show inflation rates similar to true underlying inflation so long as actual market prices for goods and services are used as primary inputs. However, given that GoA price surveys will continue to be conducted as they are being done now, most of these analysts say they believe the new index will arrive "stillborn," with little credibility.

¶9. (C) If true, this will not bode well for perceptions of

the Argentine economy by local market participants as well as by outside observers and actors. The tarnished credibility of INDEC CPI statistics has already called into question the reliability of linked GDP growth data (which independent observers argue is overstated by a low GDP deflator) and well as poverty and indigence statistics. It also puts in doubt the ability of the GoA to engineer "Social Pacts" (Reftels) between business and labor to attempt to control spiraling wage and price increases over the medium term. Clearly, at a minimum, the government will have to work very hard to establish the credibility of its new CPI Index.

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